

Best Practices

By Garrett J. Sullivan



Avoiding the Potholes in Surety Bonds

Construction is a very risky business. Since the recession began, surety companies have been taking a much closer look at the financial strength of contractors before bonding them. They clearly understand our industry is still in the process of sifting the strong from the weak – and are taking a more cautious stance with contractors who could fail.

That's why it's so important to view your financials through the lens of an outsider such as bond agent, bond underwriter, or banker. Contractors should prepare their financial presentation with the same vigor they use for a new job proposal. It's paramount that you demonstrate a very well-managed and financially sound company.

As you finalize your 2010 financials, include the items below to ensure your company puts its best foot forward for surety underwriters:

- **Balance Sheet, Income Statement & Cash Flow Statement:** Utilize the percentage of completion method.
- **Notes to Financial Statements:** Detail any issues your company is facing that may materially affect you in the future. This can include pending claims, lawsuits, subcontractor defaults, personal or company taxes owed, etc.
- **Work in Place (WIP) Statement:** Include a listing of your backlog with contract amounts, change orders, estimated profit, estimated cost to complete, and percentage completed. The more detailed, the better. For a free, downloadable spreadsheet, visit www.SullivanHi.com.
- **Accounts Receivable Log:** Group receivables by current, past 60, and over 90 days. Include the invoice date and due date.

As long as you are profitable and producing these statements on a monthly basis, you are well on your way to maintaining -- or increasing -- your bond program. The Best in Class Contractors are always diligent to carefully review their financials every month with their accountant. If you are a contractor that has never had financial training, make it your New Year's resolution to take classes on this very important aspect of your business. Your financial security depends on it.

Speaking of New Year's resolutions, below are some actions all contractors can take to stay financially healthy in 2012:

- Avoid taking personal loans from the company.
- To the maximum extent possible, have bonus distributions be only for the payment of taxes. Pay your taxes quarterly.
- Constantly evaluate your bidding margin to be sure you are not chasing work or bidding the competition.
- Every month, consciously engage your employees to help reduce or eliminate an overhead expense. Make it a priority, as every dollar saved drops right to the bottom line. Tie this to your employee's annual evaluations and include them in on the company savings.
- Track and reduce the amount of time it takes your receivables to be paid.
- Bid work only in the locations you are familiar with. If you must bid work in a new area, partner with a local company.
- Carefully review all contracts and subcontracts to ensure they mirror the terms of your cost proposal.
- Most importantly, take your bond agent to lunch at least once a year and give them an honest appraisal of the current state of your company. This, along with your best estimate of your future, will keep them apprised of your financial condition and demonstrate that you are ahead of the curve.

By consistently following these steps, you can start, maintain, or continuously increase a respectable bond program. You will desperately need this in order to remain competitive – and to survive – as the economy continually casts off financially fragile companies that are unwilling to do the hard work necessary to survive.

For a free, downloadable Work in Place (WIP) spreadsheet, visit www.SullivanHi.com. Garrett Sullivan is the President of Sullivan & Associates, Inc., a construction industry consultancy focusing on improving contractor performance. Reach him at GSullivan@SullivanHi.com, www.SullivanHi.com, or 808.478.2564.